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United We Stand

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Each Supervisor

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Subject: **ENERGY UPDATE REPORT**

This is the ninth in a series of regular reports requested by your Board to provide updates on the County's ongoing energy management activities. These reports will be provided quarterly and discuss the status of key energy related issues and responses to Board Motions and requests.

As there have been a number of significant regulatory activities in the news recently, this report will first address those issues at the California Public Utilities Commission (CPUC) and at the Federal Energy Regulatory Commission (FERC).

**Electricity Rate Issues**

**SCE General Rate Case**

As reported in our memorandum to your Board dated December 4, 2002, ISD, on behalf of the County, intervened in SCE's General Rate Case proceeding at the CPUC. This proceeding will determine SCE's revenue requirements, how those costs should be recovered from customers and quality of service issues. Phase 1 will determine SCE's revenue requirements. SCE has asked for a substantial increase in rates, ranging from 10% to 15%. Issues related to the nature of the services it provides customers like the County will also be discussed. Phase 2 of the proceeding will focus on the allocation of costs among customer classes.

In Phase 1, ISD filed written testimony in this proceeding asking the Commission to assist Edison in continuing to meet the County's energy management needs in the following areas:

- Providing automated downloading of meter data to support energy management information systems.
- Involving large customers in the development of future energy efficiency project rebate programs.

- Providing energy efficiency project financing programs that support local government borrowing guidelines.
- Providing summary information to customers that explains SCE's involvement in regulatory proceedings and their potential impact to customers.

Oral testimony in Phase 1 will likely be provided in late January 2003. We will keep your Board apprised of our activities in this issue.

### **SCE/CPUC Settlement Agreement**

As previously reported to your Board, SCE and the CPUC entered into a settlement agreement in the Spring of 2001. The settlement allowed SCE to recover the high costs of electricity that SCE incurred by allowing SCE to charge a 4-cent surcharge on top of SCE's current rates, effective March 2001.

The Federal District Court's decision to approve the settlement agreement was appealed by The Utility Reform Network (TURN). Earlier this fall, the 9<sup>th</sup> Circuit of Appeals held that the settlement violated State law in a number of respects, including violating the rate freeze statute, the State's open meeting statutes and State law governing the process whereby rate increases may be put into effect.

However, rather than rule directly, the 9<sup>th</sup> Circuit asked the California Supreme Court to review the matter. The California Supreme Court has agreed to take up the matter, and briefs will be filed in the near future. The outcome is unpredictable at this point in time.

### **California State Department of Water Resources (DWR) Bond Proceedings**

This proceeding involves the allocation of costs to recover the more than \$11 billion in bond-related costs incurred by the Department of Water Resources to finance the purchases of electricity it made for customers of the State's investor-owned utilities. State law requires the Commission to impose charges on customers sufficient to guarantee that the costs of the bonds will be recovered.

In late November of 2002, the CPUC voted to exclude the bond surcharge from residential customers that don't exceed 130% of their base electricity consumption. This has the effect of shifting more costs to other, non-residential consumers, including the County.

Additionally, the CPUC is addressing the amount of bond charges each utility must collect to repay the bonds. A preliminary decision in mid December of 2002 allocated

\$200 million more in collections for SCE customers than proposed by SCE. The final CPUC ruling to adopt this allocation will likely occur before the end of the year.

These decisions will impact SCE's rates. However, since SCE is currently recovering in rates significantly more than the current cost of power (due to the 4-cent surcharges), it is not anticipated that the County's utility expenditures will actually increase in real terms. However, they will not decrease by as much as they should have as a result of this decision.

ISD is monitoring CPUC proceedings, and other CPUC activities, in order to determine any current and future Utility Budget impacts.

### **Recent FERC Activities**

#### **FERC Investigation of Natural Gas Market Manipulation**

This proceeding is based on a complaint filed by the CPUC against El Paso, alleging that El Paso manipulated the Southern California natural gas market during 2000 and 2001, causing prices to rise to unprecedented levels. The County has participated in this proceeding through the filings of briefs in support of the position of California regulators and utilities.

The Chief Administrative Law Judge (ALJ) initially concluded that El Paso did not manipulate the market. However, after the issue was remanded back to him by the full Commission and further evidentiary proceedings were held, he reversed himself and held that El Paso had withheld significant interstate pipeline capacity from the market. The full Commission heard oral argument on the matter earlier in December, and is expected to rule in the near future.

#### **Electricity Refund Proceeding**

This proceeding involves the allegations that prices to California energy consumers were unjust and unreasonable, in violation of the fundamental protections accorded by the Federal Power Act. The Governor has alleged that California is owed approximately \$9 billion.

The County actively participated in earlier settlement discussions supporting the efforts of the California parties to reach an agreement. However, those negotiations failed to produce results satisfactory to the Governor and his negotiators. As a result, the Commission asked another Judge to determine the precise level of overcharges based on certain very specific criteria.

In the context of this very narrow, technical proceeding, the Administrative Law Judge ruled that for the period of October 2, 2000 through June 20, 2001, suppliers overcharged the State Independent System Operator (ISO) and the California Power Exchange (PX) \$1.8 billion. However, since the State still owes the suppliers approximately \$3.1 billion, the suppliers are due \$1.3 billion. The State has argued that the criteria used to reach this result was overly narrow in terms of the time period subject to the investigation, the scope of transactions that took place, the evidence made available to FERC and the impacts of alleged gas market manipulation by El Paso.

The ALJ's determination regarding the amount of overcharges (\$1.8 billion) is far less than the figure the Governor believes California is ultimately owed. For California to obtain a larger refund, the Commission will have to conclude that the marketers of electricity violated the Federal Power Act. Should they conclude this, the State could then see refunds for the time frame prior to October 2, 2000. This issue will be decided outside the parameter of the first, more narrow phase of the proceeding.

### **County Natural Gas Procurement**

ISD purchases natural gas for the County's largest users and for the cogeneration plants at Pitchess Honor Ranch, Civic Center and Olive View Hospital. The County has two (2) contracts with Pacific Gas & Electric (PG&E) Energy Trading Corp. to cover the County's supply of natural gas. The County's contract with PG&E Energy Trading Corp. that covers the Pitchess facility is based on a market index. This contract is cost neutral to the County because, under an existing agreement, SCE reimburses the plant for actual natural gas expenses. The County/PG&E Energy Trading Corp. contract to cover the Pitchess facility expired at the end of October 2002 and ISD has extended it through December of 2002. Beginning in January of 2003, ISD will purchase gas for Pitchess from the California State Department of General Services (DGS) under their gas procurement program. The pricing terms of this agreement are essentially the same as the current index contract for Pitchess.

The second gas contract is a fixed price contract to cover all other County accounts. The price the County pays for gas on this agreement is slightly below current market prices. This contract expires at the end of June 2003. The contract will extend through June of 2003. ISD will solicit new suppliers for both contracts for July 1, 2003.

### **Retrofit Projects**

Projects approved by your Board in fiscal year 2000-01 totaling \$6.7 million were completed in October of 2002. These projects included retrofits at 29 facilities including Pitchess Honor Ranch, Men's Central Jail, and Twin Towers.

Additional projects approved by your Board on May 28, 2002, totaling \$4.1 million, are underway in 27 facilities and scheduled to be completed July 2003, about 6 months earlier than previously anticipated. These projects include retrofits at the Music Center, Olive View Hospital, the Museum of Natural History, the Registrar Recorder headquarters and Courthouses in Compton, San Fernando, Beverly Hills, Long Beach, and Norwalk.

Contracts for projects to be funded by the CPUC's \$3.3 million grant are nearly complete. On June 4, 2002, your Board authorized these contracts to be signed from ISD's Master Agreement list of energy service companies. The contract signings are on schedule and the projects should be completed by the end of calendar year 2003.

### **I-6 Insurance Lawsuit**

County Counsel and ISD have negotiated a tentative settlement agreement with the I-6 Insurance provider for the County's \$5 million claim against the insurer stemming from power shortages during 2000. The insurer had earlier paid \$2.5 million. ISD filed a lawsuit seeking the remaining amount, plus attorney's fees, prejudgment interest, and damages.

The proposed settlement was approved by the County Claims Board on December 16, 2002 and is scheduled for Board for approval on January 7, 2003.

### **Other CPUC Issues**

The County remains a participant in or is monitoring in these other ongoing proceedings at the CPUC:

#### **Qualifying Facilities Payment Proceeding**

The CPUC will hold additional hearings in the future to determine a methodology for repaying QFs for their power production expenses, including natural gas purchases. The County will continue to be repaid based on its current contract price index at the California/Arizona border until June of 2007.

### **Natural Gas Lawsuit**

The County filed a lawsuit against several natural gas transporters and marketers alleging their participation in a conspiracy to eliminate competition and raise gas and electricity prices in southern California. The complaint named Sempra, San Diego Gas & Electric, the Southern California Gas Company and various affiliates of the El Paso Corporation as defendants. The San Diego Superior Court ordered the County's lawsuit coordinated with those filed by other plaintiffs, including the Cities of Los Angeles and Long Beach.

Judge J. Richard Haden has been assigned to this coordinated proceeding and has denied all of defendants' motions to dismiss the lawsuit in its early stages. The County is in the process of preparing and responding to written discovery regarding the allegations in the complaint.

### **CPUC Natural Gas Market Investigation**

In November of 2002, the CPUC opened a new investigation into the causes of the natural gas price spikes that were experienced at the southern California border from March 2000 through May 2001. The first phase of the investigation will focus on the activities of Southern California Gas Company, and whether and to what extent it played any role in the market distortions experienced at that time.

Insofar as the issues raised in this investigation could impact the County's anti-trust claims, ISD will closely monitor this proceeding and may possibly intervene.

### **Community Aggregation and Departing Load Fees**

CPUC hearings are anticipated early next year regarding charges to customers that install cogeneration power plants or participate in what remains of direct access in California. The charges for customers who generate their own power are necessary to reimburse the DWR for contracted power commitments. Similarly, governmental customers who purchase power from 3<sup>rd</sup> parties under AB 117 must reimburse the DWR.

AB 117 was signed into law this year and allows governments to aggregate their facilities, other businesses, and residences for the purposes of purchasing power from other providers. AB 117 limits this only to customers that are not currently served by municipal utilities. Only local governments may aggregate these customers. With SCE rates currently at all time highs and wholesale power prices at relatively low prices,

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there may be some financial advantages. ISD is currently investigating this opportunity on behalf of County facilities.

If you have any questions, please contact me or have your staff contact Howard Choy at (323) 881-3939.

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